Estate & Gift Taxation — Notre Dame Law School
Professor Kirsch

Brief Explanation of "Basis" for Income Tax Purposes

The following paragraphs provide a very basic overview of the relevance of "basis" in calculating a taxpayer's income taxes. This basic understanding of "basis" is necessary in an Estate & Gift Tax class because the same events that might generate gift tax or estate tax liability (i.e., a lifetime gift or an individual's death) might also impact the income tax liability of subsequent owners of the property. Given the limited purpose of this explanation, numerous details and exceptions are omitted.

Under the federal income tax, when a taxpayer sells property, she generally must treat the "gain" from the sale as income on her income tax return. Generally speaking, a taxpayer's gain upon the sale of property is calculated as follows: [1]

Gain = Sales Proceeds– Basis

In most cases, a taxpayer's basis in property equals the property's cost – i.e., the amount that the taxpayer originally paid for the property. Thus, the gain reflects the taxpayer's profit from having owned the property (i.e., the proceeds from selling the property, minus the taxpayer's original cost of acquiring the property). For example, assume the taxpayer purchased corporate stock in 2010, paying $10,000 (giving her a "basis" in the stock equal to $10,000). In 2021, she sells the stock for $14,000. The taxpayer's gain from the sale would be $4,000 ($14,000 sales proceeds, minus her $10,000 basis).[2] She generally would have to include this $4,000 gain as income on her 2021 income tax return.

When an individual receives property by gift from a living person, or by bequest or inheritance from a decedent, the recipient must determine her basis in the newly acquired property. After all, if she subsequently sells that property, she will need to know her basis in the property in order to calculate her income tax gain from that subsequent sale. Generally speaking, a taxpayer would prefer to have a higher (rather than lower) basis in the property, because a higher basis will result in a correspondingly smaller gain when the property ultimately is sold.

During the course of the semester, we will briefly discuss the rules for determining the income tax basis in property acquired by either gift or inheritance/bequest. The general rule mentioned above, which ties the basis to the taxpayer's original cost, is not directly applicable in these circumstances, given that the recipient of a gift or bequest does not pay anything in acquiring the property. Rather, as a general matter (and subject to certain exceptions), the recipient of property by gift "carries over" the basis that the donor had in the property.[3] In contrast (subject to certain exceptions), the recipient of property by inheritance/bequest takes a basis in the property equal to the property's fair market value as of the date of death of the decedent (this fair-market-value basis might be substantially higher than the decedent's basis in the property).[4]

---

[1] Technically, the gain equals the "amount realized", minus the "adjusted basis." *See* Code § 1001(a). For purposes of this simple explanation, the "amount realized" is the sales proceeds received by the taxpayer upon a sale of the property, and the "adjusted basis" is interchangeable with the term "basis".

[2] If the sales price had been less than the basis, the taxpayer would have a loss rather than a gain. For example, if she sold the stock in 2021 for $8,000, she would have a $2,000 loss ($8,000 sales proceeds, minus $10,000 basis).

[3] *See* Code § 1015.

[4] *See* Code § 1014.